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FEDERAL ELECTION COMMISSION

999 E Street, N.W.
Washington, D.C. 20463

FIRST GENERAL COUNSEL'S REPORT

SENSITIVE

AUDIT REFERRAL: 05-09

DATE REFERRED: September 29, 2005

DATE ACTIVATED: November 7, 2005

STATUTE OF LIMITATIONS: February 5, 2006 –
November 22, 2007

SOURCE: AUDIT REFERRAL

RESPONDENTS: Missouri Democratic State Committee, and Rod Anderson, in his
official capacity as treasurer

**RELEVANT STATUTES
AND REGULATIONS:**

2 U.S.C. § 432(c)
2 U.S.C. § 441a(a)(1)(C)
11 C.F.R. § 102.9(b)
11 C.F.R. § 110.4(c)(3)
11 C.F.R. § 116.5(b)

INTERNAL REPORTS CHECKED: Audit Documents
Disclosure Reports

FEDERAL AGENCIES CHECKED: None

I. INTRODUCTION

This matter was generated by a Commission audit pursuant to 2 U.S.C. § 438(b) of the Missouri Democratic State Committee ("MDSC") covering the period January 1, 2001 through December 31, 2002. On September 7, 2005, the Commission approved the Report of the Audit Division ("Final Audit Report") (Attachment 1) on MDSC, and on September 29, 2005, three out of six findings were referred to this Office for enforcement. Based on the information set forth in the Final Audit Report, this Office recommends that the Commission make reason to believe findings as follows:

- MDSC accepted \$44,445 in contributions in excess of the limitations of the Federal Election Campaign Act of 1971, as amended,¹ including \$5,675 in excessive anonymous cash contributions, 2 U.S.C. § 441a(a)(1)(C) and 11 C.F.R. § 110.4(c)(3) (Finding 2; Attachment 1 at pp. 6 and 10-13).
- MDSC accepted \$23,647 in contributions in excess of the limitations of the Act in the form of untimely reimbursements of staff advances, 2 U.S.C § 441a(a)(1)(C) and 11 C.F.R. § 116.5(b) (Finding 3; Attachment 1 at pp. 13-14).
- MDSC failed to keep proper records of its disbursements in violation of 2 U.S.C. § 432(c) and 11 C.F.R. § 102.9(b) (Finding 5; Attachment 1 at pp. 17-19).

II. CONCILIATION

¹ All of the facts recounted in this report occurred prior to the effective date of the Bipartisan Campaign Reform Act of 2002 ("BCRA"), Pub. L. 107-155, 116 Stat. 81 (2002). Accordingly, all citations to the Federal Election Campaign Act of 1971, as amended ("the Act"), herein are to the Act as it read prior to the effective date of BCRA and all citations to the Commission's regulations herein are to the 2002 edition of Title 11, Code of Federal Regulations, which was published prior to the Commission's promulgation of any regulations under BCRA.

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12 **III. STATUTE OF LIMITATIONS**
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20 **IV. RECOMMENDATIONS**

- 21 1. Open a MUR in AR 05-09;
- 22 2. Find reason to believe that the Missouri Democratic State Committee, and Rod
23 Anderson, in his official capacity as treasurer, violated 2 U.S.C. § 441a(a)(1)(C) and 11
24 C.F.R. § 110.4(c)(3) of the Act by accepting excessive contributions, including
25 excessive anonymous cash contributions;


3. Find reason to believe that the Missouri Democratic State Committee, and Rod Anderson, in his official capacity as treasurer, violated 2 U.S.C. § 441a(a)(1)(C) and 11 C.F.R. § 116.5 by accepting excessive contributions in the form of untimely reimbursed staff advances;
4. Find reason to believe the Missouri Democratic State Committee, and Rod Anderson, in his official capacity as treasurer, violated 2 U.S.C. § 432(c) and 11 C.F.R. § 102.9(b) by failing to keep proper records of its disbursements;
- 5.
6. Approve as Factual and Legal Analysis the Report of the Audit Division on Missouri Democratic State Committee, dated September 7, 2005, and
7. Approve the appropriate letters.

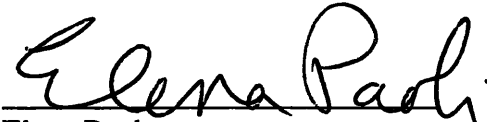
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Date


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Assistant General Counsel


Elena Paoli
Attorney

Attachments:

1. Report of the Audit Division on Missouri Democratic State Committee
- 2.

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ATTACHMENT 1

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Report of the Audit Division on the Missouri Democratic State Committee

January 1, 2001 – December 31, 2002

Why the Audit Was Done

Federal law permits the Commission to conduct audits and field investigations of any political committee that is required to file reports under the Federal Election Campaign Act (the Act). The Commission generally conducts such audits when a committee appears not to have met the threshold requirements for substantial compliance with the Act.¹ The audit determines whether the committee complied with the limitations, prohibitions and disclosure requirements of the Act.

Future Action

The Commission may initiate an enforcement action, at a later time, with respect to any of the matters discussed in this report.

About the Committee (p. 4)

The Missouri Democratic State Committee maintains its headquarters in Jefferson City, Missouri. For more information, see the chart on the Committee Organization, p.4.

Financial Activity (p. 4)

- **Receipts**
 - Total Contributions \$ 1,394,526
 - Transfers from Affiliates/Other Party Committees 3,684,789
 - Transfers from Non-federal Account for Joint Activity 9,348,606
 - All Other Receipts 259,023
 - **Total Receipts \$ 14,686,944**
- **Disbursements**
 - Operating Expenditures \$ 14,626,862
 - All Other Disbursements 217,241
 - **Total Disbursements \$ 14,844,103**

Findings and Recommendations (p. 7)

- Misstatement of Financial Activity (Finding 1.)
- Receipt of Contributions That Exceed Limits (Finding 2.)
- Apparent Excessive Contributions - Staff Advances (Finding 3.)
- Receipt of Apparent Prohibited Contributions (Finding 4.)
- Recordkeeping for Disbursements (Finding 5.)
- Disclosure of Joint Federal/Non-federal Activity (Finding 6.)

¹ 2 U.S.C. §438(b).

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Part I

Background

Authority for Audit

This report is based on an audit of the Missouri Democratic State Committee (MDSC), undertaken by the Audit Division of the Federal Election Commission (the Commission) in accordance with the Federal Election Campaign Act of 1971, as amended (the Act). The Audit Division conducted the audit pursuant to 2 U.S.C. §438(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 2 U.S.C. §434. Prior to conducting any audit under this subsection, the Commission must perform an internal review of reports filed by selected committees to determine if the reports filed by a particular committee meet the threshold requirements for substantial compliance with the Act. 2 U.S.C. §438(b).

Scope of Audit

This audit examined:

1. The receipt of excessive contributions and loans.
2. The receipt of contributions from prohibited sources.
3. The disclosure of contributions and other receipts received.
4. The disclosure of disbursements, debts and obligations.
5. The disclosure of expenses allocated between federal and non-federal accounts.
6. The consistency between reported figures and bank records.
7. The completeness of records.
8. Other committee operations necessary to the review.

Changes to the Law

On March 27, 2002, President Bush signed into law the Bipartisan Campaign Reform Act of 2002 (BCRA). The BCRA contains many substantial and technical changes to the federal campaign finance law. Most of the changes became effective November 6, 2002. Except for the period November 6, 2002, through December 31, 2002, the period covered by this audit pre-dates these changes. Therefore, the statutory and regulatory requirements cited in this report are those that were in effect prior to November 6, 2002.

History of the Audit

The Audit Process. Once the Commission has approved an audit, the Audit Division notifies the committee by letter that it has been selected. The audit notification letter outlines the audit process and lists the records necessary to conduct the audit. It also asks that certain records be provided to the Audit staff prior to fieldwork. These records include copies of all committee bank statements, copies of associated reconciliations, copies of workpapers that demonstrate the derivation of amounts that appear on disclosure reports, and copies of accounting data that are maintained electronically. The submission of these materials and electronic data permit the Audit staff to: 1) conduct some procedures prior to visiting a committee's office, 2) determine

the audit procedures that will be required in a specific case, and 3) shorten the time required to conduct the fieldwork.

When the auditors arrive at a committee's office, an inventory of the records is conducted. If it is determined that the records are substantially complete and well-organized, fieldwork will commence immediately. Audit fieldwork for a committee of the type and level of financial activity as MDSC typically takes three to four weeks to complete, if the records are substantially complete and well-organized.

Prior Audits. Including the 2001-2002 cycle, the MDSC has been the subject of audit for four consecutive election cycles.

Contacting the MDSC to arrange for the audit was difficult. The Commission approved the audit of the Missouri Democratic State Committee on July 9, 2004, and an audit notification letter was sent on July 12, 2004. A member of the Audit staff attempted to contact MDSC on July 19, 2004 to verify receipt of the letter and speak to the Treasurer to arrange for the audit. This was the first of many attempts to reach the Treasurer who was either unavailable, or did not return calls. Finally, on August 16, 2004, after the Audit staff called MDSC to verify their address in order that a subpoena could be issued, the Assistant Treasurer responded by designating an attorney to represent MDSC during the audit. As in past audits, the records were shipped to the attorney.

MDSC's Counsel was slow to respond to Audit staff requests for records. The Audit staff contacted MDSC's attorney (Counsel) on August 17, 2004 and requested that he provide the preliminary materials listed in the notification letter. Counsel stated that he would need a few days, since all of the records were in Missouri and he was unsure about the condition of the records. Six weeks later, after numerous promises to provide the materials and under the threat of being subpoenaed, Counsel provided the bank statements on September 27th and electronic files on October 1, 2004.

The electronic files were incomplete. The Audit staff determines whether the provided electronic data accurately reflects a committee's financial activity by reconciling that data to bank records and disclosure reports. The database provided by MDSC was incomplete and Counsel was informed of this immediately. The disbursements file contained 1,301 federal transactions totaling \$1.7 million, which was significantly less than the total amount of reported disbursements for the audit period of \$14.7 million. Schedules H4 (Joint Federal/Non-Federal Activity Schedule) for calendar year 2002 alone contained over 2,500 itemized disbursements. The disbursements file as provided was not usable. The receipts data was also incomplete. The file provided contained only 761 federal receipts totaling just over \$1 million. The reported receipts were \$14.7 million.

After one other unusable submission, a third set of files was provided on October 12, 2004. The receipts database was relatively complete although some data needed to be added in order for it to be used for testing. However, the disbursements data was still incomplete.

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One notable problem was that the check number field relating to 1,200 federal records (approximately 31%) was blank, so it was extremely difficult to verify which disbursements on the database actually cleared the bank account. The Audit staff attempted to use available records to fill in the blanks even though certain records that would allow the Audit staff to do this were not available, such as:

- check copies for disbursements clearing the two federal bank accounts after June 30, 2002 (The majority of MDSC's disbursements were made after June 30, 2002.),
- one page of the November 2002 bank statement, and
- a check register for MDSC's main federal checking account.

The Audit staff was eventually able to construct a database that was used to test MDSC's disbursements.

Records necessary to complete audit fieldwork were not submitted in a timely fashion. The Audit staff conducted an entrance conference on November 10, 2004 followed by an inventory of the records. On November 15, 2004, MDSC's Counsel was presented with a list of missing records that needed to be provided in order to complete the audit. On November 30, 2004, Counsel was presented with a revised list of missing records which included records previously requested and some additional items. On December 16, 2004, Counsel was again presented with a list of missing records which included many of the records previously presented and some additional items. Counsel generally responded to these requests by stating that he would contact committee officials in Missouri and ask them to ship the records.

Among other things, this list requested that MDSC provide its non-federal records for Audit staff review. Without them, the Audit staff would not be able to complete the review of shared federal and non-federal disbursements. Documentation from MDSC's media vendors was also requested.

By February 1, 2005, the Audit staff decided to end audit fieldwork, and proceed with issuing an interim report with findings based on a review of the available records. Counsel was informed that where allocation of shared federal and non-federal expenses was not able to be verified because of a lack of records, the expenses would be presumptively categorized as 100% federal and the Audit staff would request that subpoenas be issued to the appropriate parties.

An exit conference was held on February 16, 2005. Findings resulting from the audit were presented to Counsel and a MDSC representative. MDSC was given 10 business days to present documentation to the Audit staff that could potentially resolve certain findings. Among the findings presented was recordkeeping for disbursements. On the 10th day following the exit conference, Counsel provided most of the documents that had been requested but not provided throughout the audit fieldwork. The remaining undocumented disbursements are discussed in Finding 5.

MDSC was provided an interim audit report on May 31, 2005. The findings are detailed on the following pages. In MDSC's response to the interim audit report, it acknowledged the problems that are mentioned above. MDSC stated that the problems that were encountered did not reflect an intent to refuse to cooperate in the audit process. MDSC further stated that staff

turnover after the 2004 Democratic primary in Missouri, a software change, and a shift in responsibility for the maintenance of its financial data to an outside consultant, contributed to its difficulties in maintaining its documentation.

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Part II

Overview of Committee

Committee Organization

Important Dates	Missouri Democratic State Committee
• Date of Registration	September 15, 1980
• Audit Coverage	January 1, 2001 – December 31, 2002
Headquarters	Jefferson City, Missouri
Bank Information	
• Bank Depositories	1
• Bank Accounts	3 Federal, 4 Non-Federal and 1 Building Fund Accounts
Treasurer	
• Treasurer When Audit Was Conducted	Rod Anderson
• Treasurer During Period Covered by Audit	Michael Kelly
Management Information	
• Attended FEC Campaign Finance Seminar	No
• Used Commonly Available Campaign Management Software Package	Yes
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

Overview of Financial Activity (Audited Amounts)

Cash on hand @ January 1, 2001	\$ 57,493
o Total Contributions	1,394,526
o Transfers from Affiliates/Other Party Committees	3,684,789
o Transfers from Non-Federal Account	9,348,606
o All Other Receipts	259,023
Total Receipts	\$ 14,686,944
o Operating Expenditures	14,626,862
o All Other Disbursements	217,241
Total Disbursements	\$ 14,844,103
Cash on hand @ December 31, 2002	\$ (99,666)²

² See Finding 1.

Part III Summaries

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

A comparison of MDSC's reported figures with its bank statements revealed that MDSC had misstated its receipts, disbursements, and cash on hand balances on its FEC reports for calendar year 2001, as well as the ending cash on hand balance for calendar year 2002. The majority of the misstatement resulted from MDSC's failure to disclose the excessive portions of contributions it received and the associated transfers of these excessive amounts to its non-federal account, and the over-reporting of transfers from the non-federal account for shared activity. The Audit staff recommended that MDSC file amended reports to correct the misstatement of financial activity. MDSC filed amended reports to correct the misstatement of financial activity for calendar years 2001 and 2002. (For more detail, see p. 7)

Finding 2. Receipt of Contributions That Exceed Limits

The Audit staff identified 32 contributions from individuals and political committees that exceed the contribution limits by \$188,295. In addition, we identified three anonymous cash contributions that exceed the limits by \$5,675. MDSC deposited these contributions into the federal account and purportedly transferred the excessive portions into the non-federal account. Records were not provided that would allow the Audit staff to identify which contributions were transferred. The Audit staff recommended that MDSC demonstrate that these contributions were not excessive, were timely transferred to the non-federal account, or refund the excessive amounts to the contributors. In its response, MDSC provided a schedule indicating that many of the excessive contributions noted above had been "netted out" against transfers made from the non-federal account for shared activity. Although MDSC believes that this process was "the functional equivalent of an actual transfer," the practice does not comply with the Commission's regulations. Furthermore, the Audit staff determined that there are remaining excessive contributions totaling \$38,770 (\$33,770 individual contributions and a \$5,000 political committee contribution), as well as the excessive anonymous cash contributions of \$5,675. MDSC disclosed individual excessive contributions of \$33,500 on Schedules D (Debts and Obligations) of the amended reports, along with the excessive anonymous cash contributions noted above.

(For more detail, see p. 9)

Finding 3. Apparent Excessive Contribution - Staff Advances

One MDSC employee received reimbursements for expenditures totaling \$23,647 that were not properly documented. Documentation was not available to support the date that the advances were incurred by the employee. Absent such support, the Audit staff will

consider these advances to be excessive contributions until they were reimbursed. The Audit staff recommended that MDSC demonstrate that these reimbursements were made within the proper time limitations. The response did not demonstrate that the reimbursements were made timely.

(For more detail, see p. 11)

Finding 4. Receipt of Apparent Prohibited Contributions

The Audit staff identified eight apparent prohibited contributions totaling \$36,500 from limited liability companies (LLC). MDSC did not maintain records to verify that the contributing entities chose to be treated as partnerships for tax purposes and therefore eligible to make such contributions for federal purposes. After the exit conference, MDSC provided documentation from the LLCs indicating that five of the LLCs had elected to file as partnerships for tax purposes. However, no documentation was provided for the three remaining contributions totaling \$15,000. The Audit Staff recommended that MDSC either provide documentation to show that the LLC contributions were either not prohibited or refund the apparent prohibited contributions. MDSC was able to demonstrate that one of the LLC contributions in the amount of \$5,000 was not prohibited. The remaining two LLC contributions, totaling \$10,000, were disclosed as debts on Schedule D of the amended reports.

(For more detail, see p. 13)

Finding 5. Recordkeeping for Disbursements

A sample review of operating expenditures indicated that a material amount of expenditures were not properly documented. Further, 100% reviews of coordinated expenditures and media expenditures revealed similar errors. The errors were all disbursements greater than \$200 for which there were no canceled checks, wire notices, or vendor invoices. The Audit staff recommended that MDSC obtain and provide the missing records. MDSC provided documentation for the missing media expenditures.

(For more detail, see p. 15)

Finding 6. Disclosure of Joint Federal/Non-Federal Activity

MDSC made payments from its non-federal account totaling \$538,833 that appear to be for allocable expenses. Disbursements made directly from a non-federal account in payment of allocable expenses are not permitted under the Commission's regulations; nevertheless, such transactions should be disclosed, albeit in "Memo schedule" fashion, to complete the public record. The Audit staff recommended that MDSC file memo schedules H4 to disclose the expenses. MDSC demonstrated that most of the expenditures were properly payable with non-federal funds. Most of the remaining shared expenditures were disclosed as memo entries on Schedules H-4.

(For more detail, see p. 17)

Part IV

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

Summary

A comparison of MDSC's reported figures with its bank statements revealed that MDSC had misstated its receipts, disbursements, and cash on hand balances on its FEC reports for calendar year 2001, as well as the ending cash on hand balance for calendar year 2002. The majority of the misstatement resulted from MDSC's failure to disclose the excessive portions of contributions it received and the associated transfers of these excessive amounts to its non-federal account, and the over-reporting of transfers from the non-federal account for shared activity. The Audit staff recommended that MDSC file amended reports to correct the misstatement of financial activity. MDSC filed amended reports to correct the misstatement of financial activity for calendar years 2001 and 2002.

Legal Standard

Contents of Reports. Each report must disclose:

- The amount of cash on hand at the beginning and end of the reporting period;
- The total amount of receipts for the reporting period and for the calendar year; and
- The total amount of disbursements for the reporting period and for the calendar year.
- Certain transactions that require itemization on Schedule A or Schedule B. 2 U.S.C. §434(b)(1), (2), and(4).

Facts and Analysis

The Audit staff reconciled MDSC's reported activity to its bank records and determined there was a misstatement of beginning cash on hand, receipts, and disbursements in calendar year 2001. The ending cash on hand was also misstated for calendar year 2002. The following charts detail the discrepancies between MDSC's reported activity and its bank records.

2001Activity			
	Reported	Bank Records	Discrepancy
Beginning Cash Balance @ January 1, 2001	\$13,232	\$57,492	\$44,260 Understated
Receipts	\$1,341,304	\$1,284,503	\$56,801 Overstated
Disbursements	\$1,309,471	\$1,308,271	\$1,200 Overstated
Ending Cash Balance @ December 31, 2001	\$45,065	\$33,724	\$11,341 Overstated

Beginning Cash Balance – 2001

The understatement of beginning cash on hand in the amount of \$44,260 is discussed in the audit report covering 1999 and 2000.³ In the prior election cycle, MDSC also did not disclose the excessive portions of contributions it received as well as the associated transfers of these excessive amounts to its non-federal account. MDSC did not provide any reconciliations or workpapers to demonstrate how it arrived at its reported cash balance.

Receipts – 2001

The overstatement of receipts was the result of the following:

• MDSC reported on Schedules H3, (Transfers from the Non-federal Account) transfers from the non-federal account that were not supported by deposits or credits.	-	\$208,861
• Contributions from individuals not reported. Most of these contributions are the excessive portions of contributions. See Finding 2.	+	130,456
• Contributions from other political committees not reported. Most of these contributions are the excessive portions of contributions. See Finding 2.	+	21,490
• Offsets to operating expenditures not reported	+	125
• Unexplained difference	-	11
Net Overstatement of Receipts		<u>\$56,801</u>

Disbursements – 2001

The overstatement of disbursements was the net result of the following:

• MDSC did not report transfers to its non-federal account on Schedules B (Itemized Disbursements). These transfers were for the excessive portions of contributions noted above. See Finding 2.	+	\$36,982
• MDSC reported a transfer to its non-federal account that was not supported by a check or debit.	-	49,161
• MDSC did not report allocable expenditures on its Schedules H4.	+	14,640
• Contribution refunds not reported on Schedules B.	+	2,015

³ The Audit report for the previous election cycle recommended that MDSC file amended reports to correct its ending cash balance. MDSC filed amendments that corrected its ending cash balance at December 31, 2002. However, MDSC did not correct its beginning cash balance on its 2001 mid-year report.

- Contributions to federal candidates and committees not reported + 100
on Schedules B.
- Unexplained difference - 5,776

Net Overstatement of Disbursements \$1,200

2002 Activity			
	Reported	Bank Records	Discrepancy
Opening Cash Balance	\$45,065	\$33,724	\$11,341 Overstated
Receipts	\$13,339,010	\$13,402,442	\$63,432 Understated
Disbursements	\$13,380,391	\$13,535,832	\$155,441 Understated
Ending Cash Balance	\$3,683	-\$99,666	\$103,350 Overstated

Ending Cash on Hand – 2002

The \$103,350 overstatement of the ending cash on hand was the net result of the receipt and disbursement errors noted in the table above. Mainly, MDSC did not report operating expenditures totaling \$118,228 and transfers to its non-federal account totaling \$38,305. MDSC's bank statements did not show a negative balance because of a large amount of outstanding checks as of December 31, 2002.

At the exit conference, the Audit staff explained the misstatements and provided MDSC's representatives with schedules detailing the discrepancies. The representatives agreed to review the spreadsheets provided and file amended reports.

Interim Audit Report Recommendation and Committee's Response

The Audit staff recommended that MDSC amend its reports to correct the misstatements noted above, to include amended Schedules A and B as appropriate. Also, the most recent report should be amended to show the adjusted cash on hand balance with an explanation that it resulted from audit adjustments from a prior period. In response to the interim audit report, MDSC filed amended reports for calendar years 2001 and 2002 to comply with the Audit staff's recommendation, but has not adjusted its current cash on hand figure.

Finding 2. Receipt of Contributions That Exceed Limits

Summary

The Audit staff identified 32 contributions from individuals and political committees that exceed the contribution limits by \$188,295. In addition, we identified three anonymous cash contributions that exceed the limits by \$5,675. MDSC deposited these

contributions into the federal account and purportedly transferred the excessive portions into the non-federal account. Records were not provided that would allow the Audit staff to identify which contributions were transferred. The Audit staff recommended that MDSC demonstrate that these contributions were not excessive, were timely transferred to the non-federal account, or refund the excessive amounts to the contributors. In its response, MDSC provided a schedule indicating that many of the excessive contributions noted above had been "netted out" against transfers made from the non-federal account for shared activity. Although MDSC believes that this process was "the functional equivalent of an actual transfer," the practice does not comply with the Commission's regulations. Furthermore, the Audit staff determined that there are remaining excessive contributions totaling \$38,770 (\$33,770 individual contributions and a \$5,000 political committee contribution), as well as the excessive anonymous cash contributions of \$5,675. MDSC disclosed individual excessive contributions of \$33,500 on Schedules D (Debts and Obligations) of the amended reports, along with the excessive anonymous cash contributions noted above.

Legal Standard

Party Committee Limits. A party committee may not receive more than a total of \$5,000 per year from any one contributor. 2 U.S.C. §441a(a)(1)(C), (2)(C) and (f); 11 CFR §§110.1(a) and (d) and 110.9(a).

Handling Contributions That Appear Excessive. If a committee receives a contribution that appears to be excessive, the committee must either:

- Return the questionable check to the donor; or
- Deposit the check into its federal account and:
 - o Keep enough money in the account to cover all potential refunds;
 - o Keep a written record explaining why the contribution may be illegal;
 - o Include this explanation on schedule A if the contribution has to be itemized before its legality is established;
 - o Seek a reattribution of the excessive portion, following the instructions provided in Commission regulations (see below for explanations of reattribution and redesignation); and
 - o If the committee does not receive a proper reattribution within 60 days after receiving the excessive contribution, refund the excessive portion to the donor. 11 CFR §§103.3(b)(3), (4) and (5) and 110.1(k)(3)(i)(B).

Revised Regulations Applied. The Commission adopted new regulations that allow committees greater latitude to designate contributions to different elections and to reattribute contributions to joint account holders and has decided to apply these regulations to current matters. Although the new regulations were not in effect for most of the audit period, the Audit staff evaluated the excessive contributions discussed below using the new regulations.

Anonymous Contribution of Currency. A candidate or committee that receives an anonymous contribution of currency that exceeds \$50 must promptly spend the excess

amount for any lawful purpose unrelated to federal election activity. 11 CFR §110.4(c)(3).

Facts and Analysis

A review of the MDSC's receipt records identified 32 contributions from political action committees (PACs) and individuals that appeared to exceed the contribution limits by \$188,295. Seven of the excessive contributions totaling \$55,000 were from PACs. Twenty-five excessive contributions totaling \$133,295 were from individuals.⁴ In addition, there were three excessive cash contributions totaling \$5,675.

These contributions were deposited into the federal account and, according to the MDSC representatives, the excessive portions of the contributions were subsequently transferred to the non-federal account. It was MDSC's practice to only report the allowable portion of contributions received. Any amount received over the allowable limit was not disclosed, and when any excessive amount was transferred to the non-federal account, these transfers were also not reported. This practice contributed to the misstatement of financial activity for the audit period. See Finding 1.

MDSC did not maintain records to associate all of these excessive contributions with specific transfers. During calendar years 2001 and 2002, MDSC made 22 transfers to the non-federal account from its federal account totaling \$153,872. From the available documentation, we determined that \$39,300 was timely transferred for excessive portions of contributions, (the excessive portions noted above are net of this amount.), \$71,090 was transferred for the non-federal share of offsets to operating expenditures, \$5,800 was transferred for prohibited contributions, and \$37,682 was unaccounted for. It therefore appeared that most of the \$188,295 remains in the federal accounts.

MDSC did not maintain sufficient funds to make all refunds. The book balance in MDSC's bank accounts on December 31, 2002 was negative \$99,666. See Finding 1.

At the exit conference, the Audit staff gave the MDSC's representatives a schedule of excessive contributions for individuals and PACs. The Audit staff also provided a schedule of excessive cash contributions and a schedule of transfers to the non-federal account. In response, MDSC acknowledged the receipt of the contributions.

Interim Audit Report Recommendation

The Audit staff recommended that MDSC:

- Provide evidence demonstrating that the contributions in question were not excessive. Such evidence should include copies of checks that were timely refunded or were timely transferred to its non-federal account.
- Absent such evidence, refund \$193,970 (\$188,295 + \$5,675) to the contributors and provide evidence of such refunds (copies of front and back of negotiated refund checks);

⁴ The audit report on MDSC for the previous election cycle addressed a similar finding, due to MDSC's practice of not reporting contributions in excess of the limitations.

- If funds are not available to make necessary refunds, disclose those contributions requiring refunds on Schedule D (Debt and Obligations) until funds become available to make the refunds.

Committee Response and Audit staff's Assessment

In response to the interim report, MDSC stated that, in some cases, when it needed to transfer funds from the non-federal account to the federal account for the non-federal share of allocable expenses, it would "net out" the non-federal portion. This meant that, instead of transferring the excessive portion to the non-federal account, it reduced the amount of the allocation transfer from the non-federal account by the amount of the excessive contributions. MDSC provided a schedule of the portions of excessive contributions that were either transferred to the non-federal account or were "netted out." According to the schedule, MDSC believes that \$157,525 of the \$188,295 excessive contributions noted above have been effectively transferred to the non-federal account.

Further, MDSC stated that it would file amended reports which would correctly disclose the gross contributions received, along with notations indicating whether the excessive contributions were transferred to the non-federal account or netted against a non-federal allocation transfer. The non-federal portion of each excessive contribution would be disclosed on Schedules B, along with a cross-reference to the associated contribution. Finally, the remaining \$30,770 excessive contributions would be disclosed on Schedules D, and, according to MDSC, would be refunded.

Although the response states that this method of handling the excessive portions of contributions was "the functional equivalent of an actual transfer," the practice does not comply with the Commission's regulations. Furthermore, upon examination of the schedule provided with the response, the Audit staff determined that there are remaining excessive contributions totaling \$38,770 (\$33,770 individual contributions and a \$5,000 political committee contribution), as well as the excessive anonymous cash contributions of \$5,675. MDSC disclosed individual excessive contributions of \$33,500 on Schedules D of its amended reports, along with the excessive anonymous cash contributions noted above.

Finding 3. Apparent Excessive Contribution - Staff Advances

Summary

One MDSC employee received reimbursements for expenditures totaling \$23,647 that were not properly documented. Documentation was not available to support the date that the advances were incurred by the employee. Absent such support, the Audit staff will consider these advances to be excessive contributions until they were reimbursed. The Audit staff recommended that MDSC demonstrate that these reimbursements were made within the proper time limitations. The response did not demonstrate that the reimbursements were made timely.

Legal Standard

Party Committee Limits. A party committee may not receive more than a total of \$5,000 a year from any one contributor. 2 U.S.C. §441a (a)(1)(C), (2)(C) and (f); 11 CFR §§110.1(a) and (d) and 110.9(a).

Advances by Individuals from Personal Funds. When an individual uses his or her personal funds, including a personal credit card, to pay for goods or services used by or on behalf of a candidate or political committee, that payment is a contribution unless the payment falls under certain exceptions for travel (see below). 11 CFR §§100.7(b)(8) and 116.5(b).

\$2,000 Travel Exemption. An individual may voluntarily spend up to \$2,000 per calendar year for unreimbursed travel expenses on behalf of the political party without making a contribution. 11 CFR §100.7(b)(8).

Travel Expenses Exceeding \$2,000 Exemption. Payments for transportation expenses⁵ that exceed the \$2,000 travel exemption (above) are considered contributions unless the committee reimburses them:

- Within 60 days⁶, if the payments were made on a credit card; or
- Within 30 days, if the payments were made with cash or a check. 11 CFR §116.5(b).

Facts and Analysis

During calendar year 2002, one MDSC employee received 13 reimbursements for expenditures totaling \$35,406. All expenditures were classified by MDSC as travel expenditures. Documentation demonstrating that the expenditures were timely reimbursed was available for only two of these reimbursements totaling \$4,759. From the remaining \$30,647, we deducted the allowable contribution limit of \$5,000 and the allowable travel allowance of \$2,000. Absent documentation that demonstrates that the travel reimbursements were made timely, the remaining reimbursements, \$23,647, represent an apparent excessive contribution.

The matter was addressed to the MDSC representatives at the exit conference and a schedule of the reimbursements was provided.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that MDSC provide documentation to demonstrate that these reimbursements were made timely. In its response, MDSC acknowledged the insufficiencies in its documentation supporting the reimbursement of staff advances. Further, MDSC stated that there would never have been a time when the advancing staff member actually incurred outstanding excessive contributions amounting to \$23,647, unless no reimbursements were made until after all advances were incurred. Nonetheless, MDSC was not able to demonstrate that any of the reimbursements were made timely.

⁵Including usual and normal subsistence expenses (such as food and lodging) incurred while traveling on behalf of the candidate

⁶Sixty days after the closing date on the credit card billing statement where the charge first appeared

Finding 4. Receipt of Apparent Prohibited Contributions

Summary

The Audit staff identified eight apparent prohibited contributions totaling \$36,500 from limited liability companies (LLC). MDSC did not maintain records to verify that the contributing entities chose to be treated as partnerships for tax purposes and therefore eligible to make such contributions for federal purposes. After the exit conference, MDSC provided documentation from the LLCs indicating that five of the LLCs had elected to file as partnerships for tax purposes. However, no documentation was provided for the three remaining contributions totaling \$15,000. The Audit Staff recommended that MDSC either provide documentation to show that the LLC contributions were either not prohibited or refund the apparent prohibited contributions. MDSC was able to demonstrate that one of the LLC contributions in the amount of \$5,000 was not prohibited. The remaining two LLC contributions, totaling \$10,000, were disclosed as debts on Schedule D of the amended reports.

Legal Standard

Receipt of Prohibited Contributions – General Prohibition. Candidates and committees may not accept contributions (in the form of money, in-kind contributions or loans):

1. In the name of another: or
2. From the treasury funds of corporations (this means any incorporated organization, including a non-stock corporation, an incorporated membership organization, and an incorporated cooperative).

Definition of Limited Liability Company. A limited liability company (LLC) is a business entity recognized as an LLC under the laws of the state in which it was established. 11 CFR § 110.1(g)(1).

Application of Limits and Prohibitions to LLC Contributions. A contribution from an LLC is subject to contribution limits and prohibitions, depending on several factors, as explained below.

- **LLC as Partnership.** The contribution is considered a contribution from a partnership if the LLC chooses to be treated as a partnership under the Internal Revenue Service (IRS) tax rules, or if it makes no choice at all about its tax status. A contribution by a partnership is attributed to each partner by his or her share of the partnership profits. 11 CFR §110.1(e)(1). (See explanation of Partnership Contributions (PC) below.)
- **LLC as Corporation.** The contribution is considered a corporate contribution--and is barred under the ACT--if the LLC chooses to be treated as a corporation under IRS rules, or if its shares are publicly traded.
- **LLC with Single Member.** The contribution is considered a contribution from a single individual if the LLC is a single-member LLC that has not chosen to be treated

as a corporation under IRS rules. 11CFR §110.1(g)(4).

Limited Liability Company's Responsibility to Notify Recipient Committee. At the time it makes a contribution, an LLC must notify the recipient committee:

- That it is eligible to make the contribution; and
- In the case of an LLC that considers itself a partnership (for tax purposes), how the contribution should be attributed among its members. 11 CFR §110.1(g)(5).

Questionable Contributions. If a committee receives a contribution that appears to be prohibited (a questionable contribution), it must follow the procedures below;

1. Within 10 days after the treasurer receives the questionable contribution, the committee must either:
 - Return the contribution to the contributor without depositing it; or
 - Deposit the contribution (and follow the steps below). 11 CFR §103.3(b)(1).
2. If the committee deposits the questionable contribution, it may not spend the funds and must be prepared to refund them. It must therefore maintain sufficient funds to make refunds or establish a separate account in a campaign depository for possible illegal contributions. 11 CFR §103.3(b)(4).
3. The committee must keep a written record explaining why the contribution may be prohibited and must include this information when reporting the receipt of the contribution. 11 CFR §103.3(b)(5).
4. Within 30 days of the treasurer's receipt of the questionable contribution, the committee must make at least one written or oral request for evidence that the contribution is legal. Evidence of legality includes, for example, a written statement from the contributor explaining why the contribution is legal or an oral explanation that is recorded by the committee in a memorandum. 11 CFR §103.3(b)(1).
5. Within these 30 days, the committee must either:
 - Confirm the legality of the contribution: or
 - Refund the contribution to the contributor and note the refund on the report covering the period in which the refund was made. 11 CFR §103.3(b)(1).

Facts and Analysis

A review of MDSC's receipt records identified eight contributions totaling \$36,500 that appeared to be from prohibited sources.

All eight contributions totaling \$36,500 were from LLCs. MDSC did not maintain records to verify that the contributing LLCs chose, for tax purposes, to be treated as partnerships or as single member LLCs. MDSC did not represent that the contributions were transferred to the non-federal account.

At the exit conference, the Audit Staff presented the MDSC's representative with a schedule of prohibited contributions. After the exit conference, MDSC provided documentation it had obtained from five of the LLCs indicating that they had elected to file as partnerships for tax purposes. However MDSC did not provide any documentation for the three remaining contributions totaling \$15,000.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that MDSC:

- Provide documentation demonstrating that MDSC received evidence from the LLC's that they were eligible to make the contributions at the time that the contributions were made.
- For the LLC's, examples of documentation include but are not limited to; a signed statement from each LLC, a copy of the IRS Form 8832 (Entity Classification Election), a copy of IRS Form 1065 (Partnership Tax Return), or a copy of IRS Form SS-4 (Application for Employer Identification Number) indicating that the entity has elected not to be treated as a corporation by the Internal Revenue Service and is therefore eligible to make such a contribution.
- Absent such documentation, refund \$15,000 to the contributors and provide evidence of such refunds (copies of front and back of negotiated refund checks); and
- If funds are not available to make necessary refunds, disclose those contributions requiring refunds on Schedule D (Debt and Obligations) until funds become available to make the refunds.

In its response, MDSC provided sufficient documentation to demonstrate that one LLC had elected to be treated as a partnership for tax purposes, thus reducing the prohibited contributions to \$10,000. MDSC has disclosed the remaining prohibited contributions as debts on Schedules D its of amended reports.

Finding 5. Recordkeeping for Disbursements

Summary

A sample review of operating expenditures indicated that a material amount of expenditures were not properly documented. Further, 100% reviews of coordinated expenditures and media expenditures revealed similar errors. The errors were all disbursements greater than \$200 for which there were no canceled checks, wire notices, or vendor invoices. The Audit staff recommended that MDSC obtain and provide the missing records. MDSC provided documentation for the missing media expenditures but not the coordinated expenditure or operating expenditures.

Legal Standard

Required Records for Disbursements. For each disbursement, the treasurer of a political committee must keep records on the:

- Amount;
- Date;
- Name and address of the payee⁷;
- Purpose (a brief description of why the disbursement was made—see below); and
- If the disbursement was made on behalf of a candidate, the candidate's name and the office sought by the candidate.

⁷ The payee is usually the person providing the goods or services to the committee. In the case of travel advances, however, the payee is the person receiving the advance. 11 CFR §102.9(b)(2).

- If the disbursement was in excess of \$200, the records must include a receipt or invoice from the payee, or a cancelled check or share draft to the payee. If the disbursement was by credit card, the record must include the monthly statement or customer receipt and the cancelled check used to pay the credit card bill. 2 U.S.C. §432(c) and 11 CFR §§102.9(b) and 104.3(b)(3)(i).

Examples of Purpose.

- **Adequate Descriptions.** Examples of adequate descriptions of "purpose" include the following: dinner expenses, media, salary, polling, travel, party fees, phone banks, travel expenses, travel expense reimbursement, catering costs, loan repayment, or contribution refund. 11 CFR §104.3(b)(3)(i)(B).
- **Inadequate Descriptions.** The following descriptions do not meet the requirement for reporting "purpose": advance, election day expenses, other expenses, expense reimbursement, miscellaneous, outside services, get-out-the-vote, and voter registration. 11 CFR §104.3(b)(3)(i)(B).

Preserving Records and Copies of Reports. The treasurer of a political committee must preserve all records and copies of reports for 3 years after the report is filed. 2 U.S.C. §432(d).

Facts and Analysis

As previously stated, not all disbursement documentation was made available during audit fieldwork. As a result, certain testing could not be completed by the conclusion of the fieldwork. Subsequent to the exit conference, MDSC made available the majority of the documentation requested by the Audit staff at the exit conference. Our review of the documentation noted the following errors.

The Audit staff reviewed operating expenditures on a sample basis. The review indicated that a material amount of operating expenditures was not properly documented. The majority of these errors related to payroll expenditures. The only documentation available for these items was the entries on MDSC's automated reporting system. The errors were all disbursements greater than \$200 for which there were no canceled checks, wire notices, reports from the payroll service or vendor invoices.

In addition, 100% reviews of certain areas resulted in the following:

- A review of coordinated expenditures revealed that one item in the amount of \$5,552 was not adequately documented. The only documentation available for this item was the entry on the reporting system.
- A review of media expenditures identified six disbursements in the amount of \$1,576,985 that lacked adequate documentation. The disbursements were wire transfers for which the only documentation made available was the debit entries on the bank statements and the entries on the reporting system.

At the exit conference, MDSC's representatives were informed of these matters and were provided schedules, if applicable, detailing the errors. The representatives stated that they would provide additional documentation relating to these transactions.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that MDSC obtain and provide for Audit staff review, the missing documentation for disbursements. In response to the interim audit report, MDSC provided documentation for the media expenditures. The response did not address the lack of documentation for the operating expenditures or coordinated expenditure noted above.

Finding 6. Disclosure of Joint Federal/Non-Federal Activity

Summary

MDSC made payments from its non-federal account totaling \$538,833 that appear to be for allocable expenses. Disbursements made directly from a non-federal account in payment of allocable expenses are not permitted under the Commission's regulations; nevertheless, such transactions should be disclosed, albeit in "Memo schedule" fashion, to complete the public record. The Audit staff recommended that MDSC file memo schedules H4 to disclose the expenses. MDSC demonstrated that most of the expenditures were properly payable with non-federal funds. Most of the remaining shared expenditures were disclosed as memo entries on Schedules H-4.

Legal Standard

Accounts for Federal and Non-federal Activity. A party committee that finances political activity in connection with both federal and non-federal elections must establish two accounts (federal and non-federal) and allocate shared expenses--those that simultaneously support federal and non-federal election activity—between the two accounts. Alternatively, the committee may conduct both federal and non-federal activity from one bank account, considered a federal account. 11 CFR §102.5(a)(1)(i).

Paying for Allocable Expenses. Commission regulations offer party committees two ways to pay for allocable, shared federal/non-federal expenses.

- They may pay the entire amount of the shared expense from the federal account and transfer funds from the non-federal account to the federal account to cover the non-federal share of that expense; or
- They may establish a separate, federal allocation account into which the committee deposits funds from both its federal and non-federal accounts solely for the purpose of paying the allocable expenses of shared federal/non-federal activities. 11 CFR §106.5(g)(1)(i) and (ii)(A).

Reporting Allocable Expenses. A political committee that allocates federal/non-federal expenses must report each disbursement it makes from its federal account (or separate allocation account) to pay for a shared federal/non-federal expense. Committees report

these kinds of disbursements on Schedule H-4 (Joint Federal/Non-federal Activity Schedule). 11 CFR §104.10(b)(4).

Allocation Ratio for Administrative & Generic Voter Drive Costs. State and local party committees must allocate their administrative expenses and generic voter drive costs according to the ballot composition method. Under this method, a committee determines the ratio of federal offices to the total number of federal and non-federal offices expected on the ballot in the next general election in the state or geographic area. 11 CFR §106.5(d)(1) and (2).

Disclosing Refunds of Allocable Expenses. Advisory Opinion 1995-22 describes two methods of reporting refunds. Method 1 discloses the refund and the federal and non-federal shares as negative entries on the Schedules H4. Method 2 discloses the receipt of the refund as an offset to operating expenditures on the Schedules A and the federal account transfer to the non-federal account for the non-federal share is disclosed on Schedules H4.

Facts and Analysis

MDSC maintained several federal and non-federal bank accounts. They paid shared expenses from the federal accounts and transferred funds from the non-federal accounts to the federal accounts to cover the non-federal share of those expenses. To allocate administrative and generic voter drive expenses, MDSC utilized a ballot composition ratio of 29% federal and 71% non-federal which was verified by the Audit staff to be correct. The Audit staff reviewed disbursements from both the federal and non-federal accounts.

The review of all payments from MDSC's non-federal accounts identified disbursements totaling \$538,833 which appear to be allocable expenses such as salaries, payroll taxes, staff expenses, and other miscellaneous expenses. Available documentation does not indicate that any of these payments were for solely non-federal activities; therefore, the Audit staff treated them as allocable expenses. The federal portion of these expenditures is \$153,944 or 29% of \$538,833. These expenditures should have been made from the federal accounts and the non-federal portion reimbursed by the non-federal account. In order for the correct disclosure of these expenditures to be made without causing imbalances in MDSC's accounting records, they may be reported as memo entries on Schedules H-4.

At the exit conference, the Audit staff provided workpapers detailing the adjustments noted above to the MDSC representatives. The representatives indicated that most of the expenditures paid from the non-federal accounts were for redistricting costs and therefore were allowed to be paid with non-federal funds. Further, they promised to provide documentation to demonstrate that the expenditures were for redistricting.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that MDSC demonstrate that the identified disbursements paid from non-federal accounts were not allocable expenses. Absent such a

demonstration, MDSC should file Schedules H-4 (Joint Federal/Non-federal Activity Schedule) disclosing as memo entries the allocable expenditures paid from the non-federal accounts. In its response to the interim audit report, MDSC provided documentation demonstrating that some of the expenditures were not allocable. The remaining shared expenditures made from the non-federal account total \$151,072, of which the federal portion is \$43,161.32. MDSC disclosed these expenditures as memo entries on Schedules H-4.

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